No. 227

In the Supreme Court of the United States

OCTOBER TERM, 1944

FRANCISCO BALLESTER-RIPOLL, PETITIONER

v.

COURT OF TAX APPEALS OF PUERTO RICO ET AL.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

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OPINIONS BELOW

The opinion of the Supreme Court of Puerto Rico (R. 8–39 in English translation) is reported in 61 P. R. R. 474 (Spanish edition; advance sheets of May 1, 1943); the opinion of the Circuit Court of Appeals (R. 52–69) is reported in 142 F. (2d) 11.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on April 5, 1944 (R. 69). The petition for a writ of certiorari was filed on July 5, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

All of the questions presented by the petition relate to the construction and validity of certain provisions of the Income Tax Act of Puerto Rico:

1. Whether the progressive rates of taxation imposed by the Act violate the uniformity clause of the Organic Act.

2. Whether the statutory repeal of the credits on the normal tax, formerly allowed for amounts received as dividends from a domestic corporation and as partnership profits, is valid.

3. Whether the statutory provision for a mandatory joint return by husband and wife is valid as applied to community income.

4. Whether the Supreme Court of Puerto Rico properly construed the invalid higher rates for resident aliens as separable from the valid normal tax rates.

5. Whether the Supreme Court of Puerto Rico properly construed the 1941 amendments to apply retroactively to the calendar year 1940.

6. Whether the tax imposed by the 1941 amendments is confiscatory.

STATUTES INVOLVED

The statutes involved are set forth in the Appendix, *infra*, pp. 15–24.

STATEMENT

On March 15, 1941, taxpayer and his wife, residents of Puerto Rico, filed separate income tax returns for the year 1940 under the insular Income Tax Act (R. 8). Each of them reported a net income of $19,529.45, and paid a tax of approximately $450 (R. 4–5, 8). Each reported as his separate income one-half of the income received from the same sources (R. 4–5, 8).

Deductions and credits were likewise divided between them (R. 5). In the aggregate they reported a net income of $39,058.90 and paid taxes totaling $908.78 (R. 8). On August 18, 1941, the Treasurer of Puerto Rico reliquidated taxpayer's return, pursuant to Acts Nos. 31 and 159 of the Laws of Puerto Rico (1941), consolidated it with that of his wife, and eliminated certain exemptions and credits (R. 3–4, 8). The Treasurer combined the net income reported by taxpayer with that reported by his wife, thereby increasing taxpayer's return from $19,529.45 to $39,058.90; he reduced taxpayer's personal exemption (in the aggregate for both spouses) from $2,500 to $2,000, and included, for the purposes of both normal and surtax, taxpayer's income from partnership profits and dividends from domestic corporations. The Treasurer also struck out the credit of 25 percent by reason of earned net income and applied the

rates imposed by the Acts Nos. 31 and 159 of 1941. (R. 4.) Accordingly, the Treasurer notified taxpayer that he would be required to pay an additional tax of $5,661.71, making a total of $6,570.49 for the year 1940 (R. 2–3, 8). On October 1, 1941, taxpayer filed a complaint in the Court of Tax Appeals alleging that the levying of such tax was void because the procedure was not in accordance with Sections 56 and 57 of Act No. 74 of August 6, 1925, as amended (R. 6). On May 27, 1942, the Court of Tax Appeals decided that it was without jurisdiction to entertain the case, but on certiorari the Supreme Court of Puerto Rico reversed the order of the Court of Tax Appeals and held that the latter court had jurisdiction (*Ballester* v. *Court of Tax Appeals,* 60 P. R. R. 768 (Spanish edition)), and remanded the case to the Court of Tax Appeals for further proceedings (R. 6). On October 22, 1942, the Court of Tax Appeals decided the case on its merits against the taxpayer, and upheld the tax imposed by the Treasurer (R. 6). On March 9, 1943 (R. 39–40), the Supreme Court of Puerto Rico affirmed the decision of the Court of Tax Appeals upholding the "reliquidation" by the Treasurer of Puerto Rico of this income tax, except that the decision of the Court of Tax Appeals was modified (R. 39)—

> in the sense of ordering * * * that the tax to be paid by petitioner Francisco Bal-

> lester-Ripoll be calculated at the same rate as that imposed on resident citizens; * * *.[1]

The taxpayer appealed to the Circuit Court of Appeals for the First Circuit,[2] which affirmed the judgment of the insular Supreme Court (R. 69). The Treasurer did not appeal the modification by the insular Supreme Court of the judgment of the Court of Tax Appeals.

ARGUMENT

We submit that the decision below is correct and that the questions raised are neither novel nor important.

1. The progressive rates of taxation do not violate the uniformity clause of the Organic Act. Section 2 of the Organic Act (Appendix, *infra*) provides that "the rule of taxation in Puerto Rico shall be uniform." It is well settled that the analogous provisions of Article 1, section 8, of the Federal Constitution that "all Duties, Imposts, and Excises shall be uniform throughout the United States," requires only geographical uniformity. *Knowlton* v. *Moore*, 178 U. S. 41, 92; *Brushaber* v. *Union Pac. R. R.*, 240 U. S. 1, 24.

[1] Taxpayer was a citizen of Spain at the time the tax was imposed, and is now a citizen of the United States and Puerto Rico, domiciled in Puerto Rico (R. 2).

[2] The case was submitted to the court below upon an agreed statement (R. 2–44) approved by the Supreme Court of Puerto Rico (R. 44).

It is equally clear that when Congress incorporated the requirement of uniformity in the Organic Act, it intended the same meaning that had always been attributed to it in the Constitution. *Kepner* v. *United States*, 195 U. S. 100, 124; *Serra* v. *Mortiga*, 204 U. S. 470, 474; *San Juan Trading Co.* v. *Sancho*, 114 F. 2d 969, 972 (C. C. A. 1st), certiorari denied, 312 U. S. 702; *Gallardo* v. *Porto Rico Ry., Light & Power Co.*, 18 F. 2d 918, 923 (C. C. A. 1st).

The consistent legislative and administrative construction since the original enactment of the income tax in Puerto Rico supports the decision below. The provisions for progressive rates are not new; they were not added by the 1941 amendments, which merely altered the rates. On the contrary, they were part of the Insular Income Tax Act as originally enacted,[3] and have been in effect continuously since 1925. Their validity has not previously been questioned, although they have been applied to thousands of taxpayers. Clearly, denial to the insular legislature of authority to provide for progressive rates of income taxation would effectively preclude enactment of an equitable tax based upon ability to pay.

2. The amendments repealing the credits on the normal tax formerly allowed for amounts received as dividends from a domestic corporation and as partnership profits are valid. The Income Tax

[3] Section 12 and 13 of Act No. 74, of August 6, 1925.

Act at all times since its enactment in 1925 has included "dividends" and "partnership profits" in "gross income."[4] However, for purposes of computing the normal tax, a credit was allowed individuals with respect to these two items of income.[5] These sources of income have always remained subject to the surtax.

The 1941 amendments, the validity of which is attacked here, repealed this credit on the normal tax,[6] added a provision that "said normal tax may also be assessed and collected on the income received by shareholders for dividends,"[7] and broadened to some extent the definitions of "partnership"[8] and earnings of partnerships.[9] Beginning with the enactment of the Income Tax Act in 1925, the tax had also been levied upon the income of corporations and partnerships themselves, as distinguished from their stockholders or partners;[10] the amendments of 1941 changed this provision merely by increasing the rate.[11]

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[4] Section 15 (a), Act No. 74, Laws, 1925 (Appendix, *infra*, pp. 15–16).

[5] Section 18 (a), Act No. 74, Laws, 1925 (Appendix, *infra*, p. 16).

[6] Section 10, Act No. 31, Laws, 1941 (Appendix, *infra*, p. 21).

[7] Section 5, Act No. 31, Laws, 1941 (Appendix, *infra*, pp. 18–19).

[8] Section 1, Act No. 31, Laws, 1941, amending Section 2 (a), Act No. 74, Laws, 1925 (Appendix, *infra*, p. 17).

[9] Section 3, Act No. 31, Laws, 1941, amending Section 4 (a), Act No. 74, Laws, 1925 (Appendix, *infra*, p. 18).

[10] Section 28, Act No. 74, Laws, 1925.

[11] Section 14, Act No. 31, Laws, 1941.

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Taxpayer contends that these amendments are invalid as "double taxation," and that they violate the uniformity provisions of the Organic Act (Br. 60–64). Here, too, the allegedly illegal exercise of legislative power has remained in force for a period of over fifteen years. The substantial effect of the amendments is merely to apply to a lower bracket, namely, the normal tax, the tax on dividends and partnership profits which has always been collected as part of the surtax. The insular Supreme Court characterized taxpayer's contention in this regard as "frivolous" (R. 23), and the Circuit Court of Appeals found "no merit" in the contention (R. 66–67). *Welch* v. *Henry,* 305 U. S. 134, 143–144.

Similarly, the taxation of the partnership profits to the individual taxpayer, in addition to their taxation to the partnership itself, is clearly valid. "Partnership" is not here used in the common law sense. It is the rendering into English of *sociedad,* which the insular Supreme Court has held to be "a juridical person apart from the members thereof," and has ruled that to assimilate the *sociedad* with a common law partnership of the character with which the federal income tax acts are concerned is "to invoke a false analogy" (R. 24). The nature of the *sociedad,* and whether it exists as a juridical person apart from its members, present questions of local law; and the Circuit Court of Appeals properly ruled that the

insular court in so holding was not demonstrably wrong (R. 67). *Puerto Rico* v. *Russell & Co.*, 288 U. S. 476, 481.

3. The Circuit Court of Appeals did not err in sustaining the decision of the insular Supreme Court holding the statutory provision for a mandatory joint return by husband and wife valid as to community income. Section 13 of Act No. 31, Laws of Puerto Rico (1941), amending Section 24 (b) of Act No. 74, Laws of Puerto Rico (1925), provides that:

> If a husband and wife living together have a net income for the taxable year of $2,000, or over, or an aggregate gross income for such year of $5,000 or over, the total income of both shall be included in a single joint return, and the normal and additional tax shall be computed on the aggregate income. The net or gross income received by any one of the spouses shall not be divided between them.

Prior to the amendment, Section 24 (b) of the statute gave a husband and wife living together the option of making a separate or joint return. Taxpayer contended below that under the community property law of Puerto Rico the income for 1940 was owned separately by his wife and by him, and that the mandatory joint return prescribed by Section 24 (b) of the Income Tax Act, as amended, deprived him of property without due process of law in that it compelled him to pay

taxes on income belonging to his wife. The insular Supreme Court examined the Puerto Rican local community property law with reference to the nature of the interest of the wife during coverture in the community property and its income (R. 10–14, 19–20), and held that under the local law the wife has no vested interest in the community property income, *United States* v. *Robbins*, 269 U. S. 315 (R. 13–14) and that the husband is therefore taxable on all of the community property income. The insular Supreme Court further held that to provide by statute for a joint return under these circumstances is "merely to bring income tax law in line with our traditional community property concepts" (R. 20).

The nature and extent of the interest of the wife in community property income is plainly a question of local law, involving consideration of the "varying emphasis, tacit assumptions, unwritten practices," within the peculiar competence of the territorial court. *Diaz* v. *Gonzalez*, 261 U. S. 102, 105–106; *National City Bank* v. *De La Torre*, 54 P. R. R. 219, 223, 224, on reconsideration, 54 P. R. R. 651, 654, 655, affirmed, 110 F. 2d 976, 983 (C. C. A. 1st), certiorari denied, 311 U. S. 666. This Court has only recently reaffirmed the established principle applied by the Circuit Court of Appeals in the present case (R. 62) that a judgment of the Supreme Court of Puerto Rico on a question of local law will not be reversed unless

it "does violence to recognized principles of local law or established practices of the local community." *De Castro* v. *Board of Commissioners of San Juan,* decided May 29, 1944, No. 349, Oct. Term, 1943, slip opinion, p. 4; *Mario Mercado e Hijos* v. *Commins,* decided May 29, 1944, No. 497, Oct. Term, 1943; *Puerto Rico* v. *Rubert Co.,* 315 U. S. 637; *Bonet* v. *Yabucoa Sugar Co.,* 306 U. S. 505; *Waialua Co.* v. *Christian,* 305 U. S. 91, 109; *Fidelity & Columbia Tr. Co.* v. *Louisville,* 245 U. S. 54, 59–60.

4. The Circuit Court of Appeals did not err in upholding the decision of the insular Supreme Court construing the invalid higher rates for resident aliens as separable from the valid normal tax rates. The insular Supreme Court held invalid, as in violation of the equal protection clause and the uniformity clause of the Organic Act, the imposition of a higher tax rate on the income of resident aliens than on the income of resident citizens (R. 24–29). No appeal was taken on behalf of Puerto Rico from this ruling. The insular Supreme Court further held that its ruling did not nullify the entire tax imposed on taxpayer, and that he is entitled only to uniformity or equal protection, i. e., that his tax should be calculated at the same rate as that of resident citizens (R. 29).

Whether the invalid portion is severable from the valid is clearly a question of legislative intention, and like other questions of interpretation of

local statutes, rests primarily with the local court. *Dorchy* v. *Kansas*, 264 U. S. 286, 290–291. Taxing acts of Puerto Rico are "purely local" and the "traditional reluctance" of this Court to overturn constructions of such local statutes by local courts is particularly applicable to interpretations of Puerto Rican statutes by Puerto Rican tribunals. *Bonet* v. *Yabucoa Sugar Co.*, 306 U. S. 505, 510. The decision of the local court will not be reversed unless it cannot be supported by logic and reason. The Circuit Court of Appeals was clearly entitled to find that the insular court made a permissible construction of the Act (R. 66).

The courts below construed the statute so as to impose the same rate upon noncitizen residents as upon citizen residents, retaining only the distinction between residents and nonresidents. Clearly, the legislature cannot be presumed to have intended to impose no tax whatsoever under this section in the event the discriminatory rate against aliens should be held ineffective. In fact, the legislature explicitly provided against such a construction.[12] The invalidity of the larger tax rate imposed upon alien residents is of small practical importance; on the other hand, the consequence of invalidating the entire normal tax, as taxpayer contends, would entail financial difficul-

[12] Section 6, Act No. 159, Laws, 1941, provides as follows: "SECTION 6. If any provision of this Act or the application thereof to any person or circumstance is declared void, the rest of the Act, and the application of said provision to other persons or circumstances, shall not be affected."

ties of the most serious character for the insular government and population.

5. The Circuit Court of Appeals did not err in holding that the Supreme Court of Puerto Rico correctly construed the 1941 amendments to apply retroactively to the calendar year 1940. The notice addressed by the Treasurer of Puerto Rico to taxpayer reliquidating the income taxes for the calendar year 1940 was dated and received in August, 1941 (R. 2). In levying taxes for 1940 the Treasurer applied the rates imposed by Acts Nos. 31 and 159 of 1941 (R. 4) which had been enacted in April and May, respectively, of 1941. These amendatory Acts were expressly made retroactive to January 1, 1940, and applicable to the calendar year 1940.[13] Thereafter, on October 1, 1941, taxpayer commenced the present suit by filing a complaint with the Court of Tax Appeals (R. 6). While this proceeding was pending the insular legislature enacted Act No. 23 of the First Special Session of 1941, approved November 21, 1941. Taxpayer contends that Sections 1 and 11 of Act No. 23 (see Appendix, *infra,* pp. 23–24) in effect repeal the provisions of Acts Nos. 31 and 159 of April and May, 1941, which made them retroactive through the year 1940, and instead cause them to be effective only commencing January 1, 1941 (Br. 75–78). No reason is advanced by taxpayer to justify attribution of such an ex-

[13] Sections 2 and 29, Act No. 31, Laws, 1941; Section 8, Act No. 159, Laws, 1941 (Appendix, *infra*, pp. 17–18, 22, 23).

traordinary intention to the legislature, and the Supreme Court of Puerto Rico stated that it was "unable to follow the petitioner in his contention" (R. 29). Since the local court's construction was not palpably erroneous, the court below properly sustained its ruling in this respect (R. 68).

6. The tax imposed by the 1941 amendments plainly is not confiscatory. This tax was not imposed upon Puerto Ricans by an outside authority, but by their own elected representatives. The local Supreme Court declared that to sustain taxpayer's contention in this regard would require "a touch of arrogance" on its part (R. 39), and the court below held that the insular court was obviously correct in ruling that the tax of about $6,500 on approximately $39,000 of net income was not objectionable as confiscation under the guise of taxation (R. 69).

CONCLUSION

The decision of the court below is correct, and no question warranting further review is presented. It is respectfully submitted that the petition for a writ of certiorari should be denied.

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